No. 11547

In the United States Circuit Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

RAINIER BREWING COMPANY, A CORPORATION, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 37–78) are reported at 7 T. C. 162.

JURISDICTION

The Commissioner determined deficiencies in income, declared value excess profits and excess profits taxes for the year 1940 and in excess profits tax for the year 1941 and mailed notice of the deficiencies to taxpayer on March 9, 1944 (R. 16–17). On May 12, 1944, within the permitted ninety-day period, taxpayer filed a petition for review with the Tax Court for a redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue

Code (R. 2, 5–15). The hearing was held on July 19, 1945 (R. 3), and the decision of the Tax Court was entered August 12, 1946 (R. 78–79). The Commissioner's petition for review by this Court (R. 79–84) was filed November 5, 1946 (R. 4, 84) and properly invokes the jurisdiction of this Court under Sections 1141 and 1142 of the Internal Revenue Code.

QUESTIONS PRESENTED

1. Whether the $1,000,000 in promissory notes Rainier received in 1940 upon the exercise by Seattle of a licensing option constituted a lump sum royalty, and thus ordinary income to Rainier, rather than the price received for the sale of a capital asset.

2. If the $1,000,000 constituted the price received for the sale of a capital asset, whether the full amount of obsolescence of good will allowed Rainier for the years 1918 to 1920, inclusive, rather than just the amount producing a tax benefit, was "allowed" within the meaning of Section 113 (b) (1) (B) of the Code and is therefore to be deducted from the March 1, 1913, value of the trade names "Rainier" and "Tacoma" to arrive at the adjusted basis of the trade names for capital gain purposes.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Treasury Regulations are set forth in the Appendix, *infra*, pp. 77–80.

STATEMENT

The case in the Tax Court involved four questions (R. 38) but the Commissioner has appealed in respect of only two of them (R. 596–598), the other two being considered factual issues on which the Tax Court's findings are conclusive. The findings of the Tax Court pertinent to the two questions before this Court, which are based upon certain stipulations and oral and documentary evidence submitted at the hearing (R. 39), will be set forth below separately. If decision is in favor of the Commissioner on the first question, it will be unnecessary for the Court to consider the facts bearing on the second question.

Findings with respect to first issue [1]

The Rainier Brewing Company, the taxpayer in this case, is a corporation, organized under the laws of the State of California, with its principal office and place of business in the City and County of San Francisco, California. Its predecessor in interest, Seattle Brewing & Malting Company, was incorporated under the laws of the State of Washington in 1893. Its principal place of business was in Seattle, where it built a brewery and manufactured beer, ale, and other alcoholic malt beverages for sale under the trade name and brand of "Rainier." In 1903 a new corporation by the name of "Seattle Brewing and Malting Co." was organized under the laws of West Virginia. This corporation acquired all the assets of the Washington corporation, including the trade

[1] Except for a few preliminary facts as to Rainier's predecessors and a few omissions, the Tax Court's findings on this issue are identical to its findings in No. 11467, *Seattle Brewing & Malting Co.* v. *Commissioner*, which is to be argued immediately before the instant case.

name "Rainier," and operated the business until the end of 1915 when, because of state-wide prohibition, it stopped the manufacture of beer and ale in the State of Washington and began manufacturing these products at San Francisco, California, through its wholly owned subsidiary, Rainier Brewing Company, a Washington corporation, until national prohibition went into effect in 1920 (R. 39–40).

In 1925 Seattle and its wholly owned subsidiary, Rainier Brewing Company, were merged through a nontaxable reorganization into a California corporation known as Pacific Products, Inc., which was organized in 1925 for that purpose. This company acquired all the assets of the two former companies, which included the plants in Seattle and San Francisco, together with their assets, business, good will, trade-marks, trade names, and labels. In 1927 Pacific Products, Inc., acquired by purchase the right to use the trade name "Tacoma." Pacific Products, Inc., operated the business until 1932 when, through a nontaxable reorganization, "Rainier Brewing Co., Inc.," a California corporation organized in 1932, acquired all the assets of Pacific Products, Inc. (except certain designated assets not used in the conduct of its manufacturing business), including the trade names "Rainier" and "Tacoma." In 1937 Rainier Brewing Company, Inc., was merged into the Pacific Products, Inc., in a nontaxable reorganization, and Pacific Products, Inc., as the surviving company, changed its name to Rainier Brewing Company, the taxpayer here. (R. 40.)

For convenience and to prevent any confusion resulting from the fact that the taxpayer in No. 11467 now has the name "Seattle Brewing & Malting Company," the instant taxpayer and its various predecessors will be referred to simply as "Rainier."

With the repeal of prohibition in 1933, Rainier resumed the manufacture and sale of real beer, ale, and other alcoholic malt beverages under the trade name "Rainier." Such products were manufactured at the plant in San Francisco. The plant in Seattle was used only as a warehouse and sales office for distribution of the products in the State of Washington. (R. 41).

In view of the rapid expansion of business following the repeal of prohibition, the officers of Rainier, in about the year 1935, considered reopening the Seattle plant as a brewery. About that time, however, they were approached by a competing company in the State of Washington, known as the Century Brewing Association (hereinafter sometimes referred to as "Century" and sometimes as "Seattle"), with a view to acquiring the right to use the trade names "Rainier" and "Tacoma" in the manufacture and sale of beer in the State of Washington and the Territory of Alaska and to have the name Seattle Brewing and Malting Company[2] (R. 41).

The trade name "Rainier" had a well established and recognized value by reason of its use and devel-

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[2] In No. 11467, already referred to and entitled "*Seattle Brewing & Malting Co.* v. *Commissioner*," the Tax Court found as a fact that Rainier was approached "with the suggestion of a merger but would not sell any part of its business" (R. 39, No. 11467).

opment and Century was desirous of acquiring the right to use it in connection with the manufacture and sale of its own beer. The trade name "Tacoma" was less used and was not so valuable [3] (R. 41).

As a result of negotiations a contract was entered into between Rainier and Century on April 23, 1935, under which Century purchased certain property and equipment located in Seattle and certain personal property, and secured the right to use the trade names "Rainier" and "Tacoma" in the State of Washington and the Territory of Alaska in consideration of the payment of certain sums to be determined on a production basis or a minimum royalty specified therein (R. 41–42).

The contract of April 23, 1935 (R. 605–625), after reciting the mutual desire of Rainier to sell and Century to purchase Rainier's Seattle plant and certain personal property located in Seattle and the State of Washington, and of Century to secure by royalty contract and of Ranier to grant the right to use the trade names "Rainier" and "Tacoma," within the State of Washington and the Territory of Alaska (R. 605–607), and after providing in detail for the sale of the physical properties (R. 607–611), continues with the following provisions (R. 611)—

LICENSING AGREEMENT

> Seventh: Rainier hereby grants to Century the sole and exclusive perpetual right and li-

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[3] In No. 11467, *supra*, the Tax Court found that Rainier had acquired the trade name "Tacoma" in order to prevent a confusion in the labels which carried a picture of Mt. Rainier (sometimes called Mt. Tacoma) (R. 39, No. 11467).

cense to manufacture and market beer, ale, and other alcoholic malt beverages within the State of Washington and the Territory of Alaska under the trade names and brands of "Rainier" and "Tacoma" together with the right to use within said State and Territory any and all copyrights, trade-marks, labels, or other advertising media adopted or used by Rainier in connection with its beer, ale, or other alcoholic malt beverages.

Eighth: In consideration of said perpetual right and license, Century agrees to pay to Rainier in cash, lawful money of the United States, a royalty amounting to seventy-five cents (75¢) per barrel (consisting of 31 gallons) for every barrel of beer, ale, or other alcoholic malt beverages sold or distributed in the State of Washington and the Territory of Alaska under the said trade names or brands of "Rainier" and "Tacoma," up to a total of one hundred twenty-five thousand (125,000) barrels annually, and eighty cents (80¢) per barrel for all such products distributed within said territory annually in excess of said amount of one hundred twenty-five thousand (125,000) barrels; provided, however, that the minimum annual amount to be so paid by Century to Rainier shall be the sum of seventy-five thousand dollars ($75,000.00), which said amount is herein termed "minimum annual royalty." Said payments shall be made in lawful money of the United States as follows:

* * * * *

Ninth: Rainier agrees that during the period of time this agreement remains in force, it will not manufacture, sell, or distribute, within the territory herein described, directly or through or by any subsidiary company or instrumentality wholly owned or substantially controlled by it, beer, ale, or other alcoholic malt beverages, or directly or indirectly enter into competition with Century in said territory. It is understood and agreed, however, that Rainier shall have the sole and exclusive right to manufacture, sell, and distribute non-alcoholic beverages within said territory under said trade names or brands of "Rainier" and "Tacoma" and any and all other trade names or brands that it owns and desires to use.

Rainier agrees that during the period of time this agreement remains in force it will maintain in full force and effect Federal registration of said trade names or brands "Rainier" and "Tacoma" and will likewise maintain in full force and effect the present registration of said trade names or brands within the State of Washington and Territory of Alaska. Should Rainier fail to so maintain its rights under said trade names or brands, then and in that event Century shall have the right to pay any and all amounts necessary to so maintain said trade names or brands for and in the name of Rainier, and shall be entitled to deduct any and all amounts so paid from the royalties then due or thereafter becoming due under this agreement.

Tenth: Century agrees that any and all beer, ale, or other alcoholic malt beverages manufactured by it pursuant to this agreement and marketed under said trade names and brands of "Rainier" and "Tacoma" shall at all times be of a quality at least equal to the quality of

> similar products then manufactured and marketed under said trade names and brands by Rainier; and shall be manufactured under the same formulae used in the manufacture of similar products by Rainier, which formulae Rainier shall make available to Century.
>
> * * * * *

The "Licensing Agreement" part of the contract also contained, in paragraph Eleventh, provisions for postponement of the time for payment of the royalty by Century in the event Century was prevented from manufacturing, selling and distributing beer, ale or other alcoholic malt beverages under the trade names for a period of time in excess of three months due to certain named causes; for diminution of the minimum royalty payable in the event local prohibition laws became effective in any portion of the territory covered by the agreement; and an option in Century to terminate the agreement or to submit to arbitration the question of adjusting the minimum royalties payable, in the event Century should be prevented from manufacturing, selling and distributing beer, ale or other alcoholic malt beverages in a quantity less than 52,000 barrels annually, due to governmental action, war regulations, or general prohibitionary laws adopted by the United States or State of Washington (R. 615–617). Paragraph Twelfth provided that the physical properties purchased by Century from Rainier, or the proceeds derived from a sale thereof by Century, were to stand as security of all Century's obligations under the contract and that in the event of default by Century Rainier should also be entitled to recover all royalties due and payable (R. 617–619).

Paragraph Thirteenth, also a part of the "Licensing Agreement," provided (R. 619):

> Thirteenth: It is understood and agreed by and between the parties hereto that at any time after this agreement has been in force for five (5) years, Century shall have the right and option of electing to terminate all royalties thereafter payable hereunder by notifying Rainier of its election so to do, and by executing and delivering to Rainier the promissory notes of Century aggregating in principal amount the sum of one million dollars ($1,000,000.00) dated as of the date of the exercise of such option, bearing interest from date at the rate of five percent (5%) per annum, which said promissory notes shall be divided into five (5) equal maturities and shall be payable respectively on or before one (1), two (2), three (3), four (4), and five (5) years after the dates thereof.

Paragraphs Fourteenth through Twenty-Fifth (R. 619–625) were entitled "Miscellaneous Provisions" (R. 619). Paragraphs Fourteenth, Fifteenth, and Sixteenth provided as follows (R. 619–621):

> Fourteenth: Century agrees that in the operation of its business during the period of time that this agreement remains in force, and from and after August 1st, 1935, it will purchase from Rainier such quantities of malt as shall be required by it in the manufacture of beer, ale, and other alcoholic malt beverages under the trade names and brands of "Rainier" and "Tacoma"; provided, however, that any such malt so purchased from Rainier shall be purchased upon terms and conditions equally as favorable to Century for like quality malt as

terms and conditions offered to it by other concerns selling malt within the territory herein described.

Fifteenth: Century agrees that during the period of time this agreement remains in force, it will use its best efforts to increase the volume of sales of beer, ale, and other alcoholic malt beverages manufactured and sold under the trade names and brands "Rainier" and "Tacoma" so that the same shall equal the volume of the sales of all other such products manufactured and sold by Century under other brands within the territory herein described. Century further agrees that during the first two (2) years that this agreement shall be in force, it shall expend for the purpose of advertising such beverages sold under the trade names and brands of "Rainier" and "Tacoma" an amount equal and equivalent to the sum expended by it during said period in advertising all other beverages manufactured and sold by it under other brands within the territory herein described, and that thereafter and as long as this agreement shall remain in force, it will expend in the advertising of the products manufactured and sold under said trade names and brands "Rainier" and "Tacoma" an amount per barrel equal and equivalent to the amount per barrel expended by it in advertising other beverages manufactured and sold by it under any and all other brands within the territory herein described.

Sixteenth: Century agrees that it will, from time to time and when and as requested by Rainier, sell to Rainier, for distribution by Rainier outside of the territory herein de-

> scribed, products manufactured under said trade names and brands "Rainier" and "Tacoma," which said products shall be sold by Century to Rainier at the cost thereof to Century; and Rainier agrees that it will, from time to time and when and as requested by Century, sell to Century, for distribution by Century within the territory herein described, products manufactured by it in its San Francisco plant under said trade names and brands of "Rainier" and "Tacoma," which said products shall be sold by Rainier to Century at the cost thereof to Rainier. Provided, however, that neither party shall have the right to request delivery of, or purchase, products hereunder in an amount in excess of the surplus products then available for sale by the other party.

Under paragraph Seventeenth Rainier agreed to change the name of its subsidiary, Seattle Brewing and Malting Company, so that Century could use the name or cause a new corporation to be organized with the name. (R. 621–622.) Under paragraph Eighteenth Rainier agreed to transfer to Century two contracts connected with Rainier's Seattle station. (R. 622.) It was also agreed, under paragraph Nineteenth, that Rainier was to transfer to Century all accounts receivable relating to Rainier's business in the territory granted to Century and that Century was to collect the accounts and deposit the collections to Rainier's credit. (R. 622.) The agreement further provided (R. 624–625):

> Twenty-Second: In the event that Century shall fail to fully and promptly carry out the the terms and provisions of this agreement or

to pay, in the manner and at the times herein provided, the payments herein agreed to be paid by it, and such failure continues for a period of thirty (30) days after written notice to it by Rainier, then and in that event, such failure shall be and become an event of default, and Rainier shall cancel this agreement by written notice to Century. Upon Rainier so notifying Century any and all rights of Century hereunder shall immediately terminate and the liquidated damages, herein in paragraph Twelfth provided, shall be immediately transferred and delivered to, and become the property of, Rainier, without, however, in any way restricting the right of Rainier to enforce payment of any and all amounts then due it hereunder.

* * * * *

Twenty-Fourth: This agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns; provided, however, that no rights of Century hereunder shall be assigned by it without the written consent of Rainier first had and obtained.

Twenty-Fifth: Time is of the essence of this agreement.

The contract was carried into execution. In pursuance of paragraph Seventeenth of the agreement Century changed its name from Century Brewing Association to "Seattle Brewing & Malting Company." Rainier withdrew from the sale and distribution of its alcoholic malt products in Washington. The Seattle plant was deeded by Rainier to Century and Century conveyed the Seattle plant to a bank as trustee and executed its trust indenture with Rainier as beneficiary, all in accordance with the terms of the agreement (R. 50).

From time to time thereafter various amendments (R. 629–692) were made to the contract of April 23, 1935, none of which substantially affected the provisions respecting the use of the trade names (R. 50). Of the amendments, one, dated November 27, 1935,[4] provided (R. 690):

> Fourth: Notwithstanding the provisions of Paragraph Ninth of said agreement it is understood and agreed by and between the parties hereto that Rainier is hereby given the special right to sell its special brand known to the trade and labelled and designated as "Rainier Special Export" beer to the Alaska Commercial Company f. o. b. San Francisco for delivery in the territory of Alaska at a price not less than that for which Century would sell such brand f. o. b. Seattle, which right shall continue until ten (10) days after receipt by Rainier of written notice from Century requesting that it discontinue such sales.

Another amendment, under the same date, amended paragraph Sixteenth, which related to the sales of beer by each party to the other for distribution in the territory of the other. This amendment provided that sales to the other should be made at a price

[4] The record in the present case uses March 27, 1935, as the date but is apparently a printing error. (See R. 168; R. 163, No. 11467.)

agreed upon by the parties prior thereto, instead of at cost as the original agreement provided (R. 691).

Thereafter Century, which became the "Seattle Brewing and Malting Company" and will hereafter be called "Seattle," operated under the licensing agreement until July 1, 1940, and royalties paid pursuant thereto were claimed and allowed as deductions for income tax purposes (R. 50–51). During the period from June 30, 1935, to July 1, 1940, Seattle sold alcoholic malt beverages in Washington and the Territory of Alaska under the name of "Rainier" in quantities set out below and paid "royalties" thereon as follows (R. 51):

Year ended June 30—	*Barrels sold*	*Royalties paid*
1936	60, 171. 51	$75, 000. 00
1937	82, 881. 50	75, 000. 00
1938	114, 308. 16	85, 731. 12
1939	112, 538. 17	84, 403. 63
1940	131, 355. 59	98, 834. 47
Total	501, 254. 93	418, 969. 22

On July 1, 1940, Seattle exercised the option granted to it in paragraph Thirteenth of the agreement and executed and delivered to Rainier promissory notes in the aggregate amount of $1,000,000 bearing interest at five percent and payable on five equal maturity dates of one, two, three, four, and five years, respectively, thereafter. These notes were made payable to Rainier. Note No. 1, in the amount of $200,000, was paid on its due date July 1, 1941. Notes Nos. 2 and 3, for $200,000 each, payable on July 1, 1942, and July 1, 1943, respectively, were paid in 1942. In consideration for the advance payment Rainier granted to Seattle, subject to all the terms and conditions of the contract of April 23, 1935, the "sole and perpetual right and license" to manufacture and market alcoholic malt beverages within the State of Idaho under the trade names and brands "Rainier" and "Tacoma" without any payment therefor other than the payment of the remaining promissory notes given by Seattle in settlement of all royalty payments under the agreement of April 23, 1935 (R. 51–52).

In the fall of 1942 Seattle arranged to pay in advance the notes of July 1, 1944, and July 1, 1945, in the principal amount of $200,000 each, together with interest thereon, less $10,000 of such interest, in consideration of Rainier (1) releasing the properties held by the First National Bank of Seattle, as trusee, from the lien thereon and directing the conveyance of such property to Seattle; (2) releasing the provisions in the contract of April 23, 1935, for the purchase of malt from Rainier; and (3) amending the contract of April 23, 1935, so as to permit the manufacture and sale of beer under the trade names of "Rainier" and "Tacoma" to any plant or plants owned or controlled by Seattle within the States of Idaho and Washington and the Territory of Alaska without the necessity of securing the written consent of Rainier in connection therewith (R. 52).

Aside from the changes indicated above as consideration for advance payment of the notes and accrued interest thereon, no changes were made in the contract of April 23, 1935, after the election by Seattle to exercise the right to "terminate the payment of all royalties" by the payment of $1,000,000 (R. 52).

Upon the exercise of the option and the execution and delivery to Rainier of its promissory notes aggregating $1,000,000, Seattle acquired the perpetual and exclusive right to manufacture and market beer, ale, and other alcoholic malt beverages within the State of Washington and the Territory of Alaska without any further payments and without regard for the amount of alcoholic malt beverages so manufactured and sold (R. 53).

By the exercise of the opinion, as provided in paragraph Thirteenth of the contract, and the payment of the consideration of $1,000,000, Seattle acquired the exclusive and perpetual right to manufacture and sell alcoholic malt beverages in the designated territory under the trade names "Rainier" and "Tacoma" (R. 53).

From the time of its organization in 1893 to 1915 Rainier had brewery and manufacturing facilities located at Seattle in the State of Washington. In the fall elections of November 1914, the State of Washington adopted prohibition, effective January 1, 1916, and in 1915 Rainier moved its manufacturing business from the State of Washington to the State of California, where it built a brewery at San Francisco and removed thereto all of the brewing machinery from its Washington plant, except the cold storage facilities. After 1915 the plant in Seattle was not operated as a brewery, but was used for storage of "Rainier" products which were shipped from San Francisco for sale in the State of Washington. These products during the era of national prohibition consisted of near beer containing one-half of one per cent alcohol (R. 53–54).

Upon the repeal of prohibition in 1933 Rainier began the sale of "Rainier" beer and other alcoholic malt beverages in the State of Washington under the trade name "Rainier," which it continued until 1935, when it entered into the agreement under which Seattle acquired the exclusive and perpetual right to manufacture and sell alcoholic malt beverages under the trade names "Rainier" and "Tacoma" in the State of Washington and the Territory of Alaska and Rainier agreed not to compete with Seattle in the sale of alcoholic malt beverages under these trade names in the limited territory designated in the agreement (R. 54).

From 1908 (and prior thereto) until 1913 Rainier sold alcoholic malt beverages under the trade name "Rainier" in the States of Washington, Montana, Nevada, Arizona, California, and Oregon, and also exported beer to the Orient, Central America, Honolulu, and South America (R. 54).

In determining a deficiency against Rainier, the Commissioner treated the $1,000,000 received by Rainier in 1940 as ordinary income and included the entire amount in its gross income (R. 60–61).

On the basis of the above facts, the Tax Court stated in its findings that "This transaction [respecting the exercise of the option by Seattle] constituted the sale and acquisition of a capital asset" (R. 53). In its opinion in the case the Tax Court relied entirely upon its decision in No. 11467, *Seattle Brewing & Malting Company* v. *Commissioner,* and assumed, erroneously we believe, that, since it had held that Seattle acquired a capital asset by the payment of the $1,000,000, the $1,000,000 received by Rainier from Seattle necessarily represented the sale price of a capital asset and therefore was not ordinary income to Rainier (R. 61–62).

Findings with respect to second issue

The Tax Court found as a fact that the fair market value, as of March 1, 1913, of the trade names "Rainier" and "Tacoma" apportionable to the State of Washington and Territory of Alaska was $514,142 (R. 59). If the Tax Court was correct in concluding that a sale resulted in 1940 from Seattle's exercise of its option, a question is presented as to whether, in computing Rainier's capital gain, an adjustment is to be made for obsolescence allowed Rainier in 1918–1920, inclusive.

The facts found by the Tax Court bearing on the obsolescence issue are as follows:

Rainier filed income tax returns for the years 1918, 1919, and 1920, but claimed no deductions therein for obsolescence of good will or trade names. In July 1920, Rainier filed a claim for abatement of taxes for the year 1919, based on a claim for obsolescence of good will. In this claim it computed the value of its good will as of March 1, 1913 (based on the average invested capital for the years 1903 to 1913, inclusive, which was capitalized at 10 percent and an average earning for the same period of $81,336.04 which was capitalized at 15 percent), to be $542,240.27. The Commissioner computed the good will value as of

March 1, 1913, to be $406,680.20, which was arrived at by using the same figures as those used by Rainier, but changing the capitalization rate of good will from 15 percent to 20 percent (R. 60). He then allocated the amount of $406,680.20 to the following years in the following amounts (R. 60):

1918	$345, 061. 95
1919	59, 153. 48
1920	2, 464. 77
Total	406, 680. 20

Rainier derived tax benefits from such allocation as follows (R. 60):

1918	$78,983. 92
1919	59, 153. 48
Total	138, 137. 40

On this issue the Tax Court held that an adjustment for obsolescence was to be made only for the amount of tax benefit received by Ranier, which was $138,137.40 (R. 67–72).

STATEMENT OF POINTS TO BE URGED

The Commissioner's Statement of Points is set out in the record at pp. 596–599. We are not relying upon point 5, R. 598. Point 1, which relates to the amount of the excess profits tax deficiency for 1941, will be answered by this Court's decision as to the amount of Rainier's 1940 income, the reduction in excess profits tax for 1941 having resulted from a carry-over credit from 1940 which would apparently be eliminated under our contentions as to Rainier's 1940 income.

Briefly, we contend as follows:

1. That the Tax Court erred in holding that the $1,000,000 in promissory notes Rainier received in

1940 from Seattle upon the exercise by Seattle of its option was gain from the sale of a capital asset rather than ordinary income.

2. Assuming that there was a sale of a capital asset, that the Tax Court erred in holding that only the amount of obsolescence allowed in 1918–1920, inclusive, which produced a tax benefit, rather than the full amount of obsolescence allowed, is to be taken into account in adjusting Rainier's basis for the determination of gain from the sale.

SUMMARY OF ARGUMENT

I

This Court's power of review on the first issue is not in any way restricted by the doctrine of *Dobson* v. *Commissioner,* 320 U. S. 489. It is undisputed, on the basis of the agreement itself, that Rainier retained the right to use the trade-marks "Rainier" and "Tacoma" on beer, ale, and other alcoholic malt beverages outside of Washington and Alaska and also the right to use the trade names within Washington and Alaska on non-alcoholic beverages, and was to maintain the registrations on the trade-marks in Washington and Alaska, and that Seattle, on the other hand, both before and after its exercise of its option, had only the limited right to use the trade-marks in Washington and Alaska, to use them in those two areas only in connection with the manufacture and sale of beer, ale and other alcoholic malt beverages, and could not assign or license those rights without Rainier's consent. The question whether these undisputed facts established a "sale of capital assets" within the meaning of Section 117 of the Internal Revenue Code is a clear-cut question of law according to decisions of the Supreme Court, including the decision on rehearing in the *Dobson* case itself, *Dobson* v. *Commissioner,* 321 U. S. 231. While it is not particularly material, the Tax Court's fundamental error was in assuming that since Seattle received a capital asset there was necessarily a "sale" of a capital asset.

As a matter of law, no sale of a capital asset resulted in 1940 when Seattle exercised its option under the April 23, 1935, agreement and the $1,000,000 in promissory notes Rainier received from Seattle was therefore a lump-sum royalty and ordinary income, not gain from the sale of a capital asset. According to the April 23, 1935, agreement, under which the option was exercised, the lump-sum payment was merely a substitute for the annual royalties on a barrelage basis Seattle had previously been paying for its so-called "perpetual" license, and it is settled that a lump-sum payment may constitute a royalty. Assuming that good will may be the subject of a "sale" within the meaning of Section 117 of the Code, a "sale" requires a transfer of "property" and there was no transfer of property in this case. The protection of the good will and trade reputation of a business is the only "property" represented by a trade-mark and a trade-mark is therefore "property" only when transferred with the business itself. Rainier did not transfer its business to Seattle; it merely sold a plant in Seattle which had not been used as a brewery since 1915 and continued in business in San Francisco just as it had previous to the agreement except that it no longer sold "Rainier" and "Tacoma" beer in Washington and Alaska. Seattle merely received a limited right to use the trade-marks "Rainier" and "Tacoma" in Washington and Alaska for the one purpose—the manufacture and sale of beer, ale and other alcoholic malt beverages—and Rainier's grant of this right only conferred authority on Seattle to infringe upon Rainier's property rights in the trade-marks in Washington and Alaska, rather than being a transfer of the property represented by the trade-marks. Further, there must be a transfer of the absolute and complete property in a thing to constitute a sale and Seattle obviously did not receive the absolute and complete property in anything. Moreover, assuming that, as in patent cases, there may be a sale of trade-marks for a specified area, Rainier did not transfer and Seattle did not receive full and complete ownership of the trade-marks in Washington and Alaska; Seattle had the right to use the trade-marks only in connection with the manufacture and sale of alcoholic malt beverages, whereas Rainier retained the right to use the trade-marks in the same areas on nonalcoholic beverages, and Seattle was given no power to assign or license even its limited rights without Rainier's consent. Nor was there even a complete and absolute transfer of the trade-mark rights for the one purpose of use in connection with the manufacture and sale of alcoholic malt beverages, for Rainier retained such rights of use and complete ownership of the trade-marks for areas other than Washington and Alaska.

II

Assuming that there was a sale, in determining Rainier's gain from the sale the March 1, 1913, value of the trade-marks, which the Tax Court found to be $514,142, must be adjusted by the full amount of obsolescence of Rainier's good will resulting from prohibition and allowed Rainier in 1918 through 1920, and not just, as the Tax Court held, by the amount from which Rainier received a tax benefit. Since Rainier sought a refund of taxes for 1919 based on a claim for a deduction for obsolescence in an amount greater than the amount of $406,680.20 allowed by the Commissioner and allocated by him to the years 1918 through 1920 pursuant to such claim, and since Rainier received tax benefits therefrom for both 1918 and 1919, Rainier must be deemed to have claimed obsolescence in the amount of $406,680.20. That amount was therefore "allowed" as obsolescence within the meaning of Section 113 (b) (1) (B) of the Code despite the fact that Rainier's tax benefit was in a lesser amount. *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523. Other decisions reflect that the full amount was not any the less "allowed" simply because it later appeared that no obsolescence was "allowable" for obsolescence of good will resulting from prohibition.

ARGUMENT

The first question in this case is whether the $1,000,000 in promissory notes Rainier received from Seattle in 1940 represented a lump sum royalty for a license, in which case the $1,000,000 was ordinary income to Rainier and taxable in full under Section

22 (a) of the Internal Revenue Code (Appendix, *infra*), or the sale price of a capital asset, in which event taxability would be governed by Sections 111–113, inclusive, and Section 117 (Appendix, *infra*). It is our position that, contrary to the Tax Court's conclusion, the $1,000,000 was a lump sum royalty for a license, as Seattle argues in No. 11467, entitled *Seattle Brewing & Malting Co.* v. *Commissioner.* The Tax Court treated the transaction as the sale of a capital asset and therefore was required to answer questions involved in a determination of Rainier's gain from the sale. The second question we have raised on this appeal is as to the correctness of the Tax Court's decision on one of the elements involved in that determination, but that question need not be considered, of course, if the Court agrees with our position that the Tax Court erred in holding that the transaction constituted the sale of a capital asset.

I

The $1,000,000 in promissory notes Rainier received from Seattle constituted an advance lump sum royalty for a license and thus ordinary income to Rainier, not the price received for the sale of a capital asset

A. The $1,000,000 could constitute an advance lump sum royalty, and hence ordinary income to Rainier, even though by its payment Seattle acquired a capital asset

As the Supreme Court stated on rehearing in *Dobson* v. *Commissioner,* 321 U. S. 231, 231–232:

> * * * not every gain growing out of a transaction concerning capital assets is allowed the benefits of the capital gains tax provision. Those are limited by definition to gains from

> "the sale or exchange" of capital assets. Internal Revenue Code § 117 (a), (2), (3), (4), (5).

Even when there is a "sale," the capital gains provisions (see Appendix, *infra*) will not apply unless the sale is of something coming within the definition of a capital asset, which, among other things, excludes depreciable property. It is not settled whether good will, which a trade-mark protects, comes within or without the definition of a capital asset. The Circuit Court of Appeals for the Second Circuit has held that good will is depreciable and therefore not a capital asset, from which it would follow that gain from the sale of good will would be ordinary income and not gain from the sale of a capital asset within the meaning of Section 117 of the Code. See *Williams* v. *McGowan*, 152 F. 2d 570 (C. C. A. 2d). But assuming that good will may be a capital asset within the meaning of Section 117, a transaction involving good will must constitute a "sale or exchange" before the consideration therefor will be deemed capital, rather than ordinary, income. A transaction involving the receipt of good will by one party is not, of course, automatically a "sale." See *Welch* v. *Helvering*, 290 U. S. 111. And, as the Circuit Court of Appeals for the Tenth Circuit stated in *Sunray Oil Co.* v. *Commissioner*, 147 F. 2d 962, 966, certiorari denied, 325 U. S. 861—

> Not infrequently, payments made for an article constitute a capital investment by the payor, but income to the recipient. * * *

For example, a contract under which one company, for a consideration, promises not to compete with a second company in a given area would constitute a capital asset to the second company but would not be the transfer of such "property" as is essential to a "sale." [5]

[5] The Tax Court recognized this in the present case under its decision on the fourth issue (R. 72–78) when it stated (R. 74):

"Without any question, it is well settled that any amount received for an agreement not to compete would be taxable as ordinary income. *Estate of Mildred K. Hyde*, 42 B. T. A. 738; *John D. Beals*, 31 B. T. A. 966; affd., 82 Fed. (2d) 268; *Christensen Machine Co.*, 18 B. T. A. 256; *Christensen Machine Co.* v. *United States* (Ct. Cls.), 50 Fed. (2d) 282. * * *"

The fourth issue was as to what part, if any, of the $1,000,000 was received by Rainier for its agreement not to compete with Seattle in the manufacture and sale of beer, ale and other alcoholic malt beverages in Washington and Alaska, as set forth in paragraph Ninth of the April 23, 1935, agreement (R. 614). The Tax Court held that no part of the $1,000,000 was paid for the agreement not to compete and the Commissioner has not appealed as to this issue, since it is primarily a factual question.

The Tax Court's holding on the issue may appear incongruous to this Court, as it does to us, and for that reason it might be noted that the decision on the point ignores the realities of the situation. The Tax Court conceded that "It is obvious that in 1935, when the contract between petitioner and Century was entered into, an agreement not to compete had a substantial value" (R. 74) but then stated, on the basis of *Cooper & Co.* v. *Anchor Securities Co.*, 9 Wash. 2d 45, where, unlike the present case, there was a sale of the entire business together with the good will, that it was doubtful that Rainier could have sold the same beer under another name and advertised that fact without being enjoined by Seattle (R. 75). The Tax Court then goes on to conclude that Seattle had so advertised and built up the trade name "Rainier" in Washington and Alaska during the five-year period between the execution of the agreement and Seattle's exercise of the option that any value which the agreement not to compete had in 1935 had been exhausted in 1940, when Seattle exercised its option. Thus, the Tax Court wholly failed to recognize that if Rainier had not agreed

Accordingly, if what Seattle received was a perpetual "license" to use Rainier's trade-marks "Rainier" and "Tacoma," the license was a capital asset to Seattle, as we have shown in our brief in No. 11467, but the consideration Seattle paid for it ($1,000,000 in promissory notes) was a lump sum royalty and thus ordinary income to Rainier, not gain from the sale of a capital asset. The lump sum would be analogous to the cash bonus paid by a lessee as consideration for an oil and gas lease. Such a cash bonus has been held to be an advance royalty and thus ordinary income, not gain from the sale of a capital asset. *Burnet* v. *Harmel,* 287 U. S. 103. On the other hand, the advance royalty, while ordinary income to the lessor, is a capital investment as to the lessee, paid as consideration for the right to exploit the land for oil and gas. *Sunray Oil Co.* v. *Commissioner, supra; Canadian River Gas Co.* v. *Higgins,* 151 F. 2d 954 (C. C. A. 2d); cf. *Quintana Petroleum Co.* v. *Commissioner,* 143 F. 2d 588 (C. C. A. 5th).

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not to compete with Seattle it could have sold "Rainier" beer in Washington and Seattle and any advertising or good will built up by Seattle during the five-year period would apply to "Rainier" beer and not just to Seattle's business. "Rainier" beer would be "Rainier" beer to a beer drinker no matter whose name appeared on the label as the manufacturer, especially since Seattle's "Rainier" beer was required, under the agreement, to be made from malt purchased from Rainier and according to Rainier's formulae. Obviously, therefore, if Rainier had not agreed not to compete with Seattle in Washington and Alaska and had sold "Rainier" beer in Washington and Alaska, Seattle's sales would have been diminished to some extent, depending upon how many distributors purchased from Rainier instead of from Seattle. It follows that Rainier's agreement not to compete must have had some value in 1940.

In *Canadian River Gas Co.* v. *Higgins, supra,* the taxpayer argued that the advance royalties it paid as lessee were deductible on a yearly allocation basis as part of the cost of goods sold, on the theory that, since the advance royalties were taxable as ordinary income to the lessor, they could not constitute the consideration for the transfer to the lessee of any economic interest in the oil or gas in place and, instead, constituted payment in advance for the oil and gas to be extracted. In reply to this argument the Circuit Court of Appeals for the Second Circuit stated (151 F. 2d at 956):

> The fallacy of that argument lies in the assumption that since the advance royalties are taxed to the lessor or ordinary income because they are part of the consideration passing to the lessor for granting to the lessee the right to obtain a series of transfers of the oil as produced, *Burnet* v. *Harmel, supra,* the grant in the hands of the lessee is not to be treated as a capital asset nor the advance royalties paid for it as a capital investment. * * *
> What the lessor gets *for* the lease and how that should be taxed does not control decision as to the character of what the lessee gets *under* the lease. Just as advance royalties may be consideration for a lease and also ordinary income to the lessor, *Burnet* v. *Harmel, supra,* they may be capital investments by a lessee when paid for capital assets. They are analogous to rentals that are taxable as income to a landlord though they may be bonuses or advances which the lessee must capitalize. *Baton Coal Co.* v. *Commissioner,* 3 Cir. 51 F. 2d 469.

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> So it does not follow, as the plaintiff argues, that because the advance royalties are taxable as ordinary income to the lessors the lessee did not make a capital investment when it paid them in consideration of the leases. * * *

Similarly, in *Sunray Oil Co.* v. *Commissioner, supra,* where the taxpayer also contended that it was entitled to exclude from its gross income an aliquot part of the advance royalties paid by it to the lessors, the Circuit Court of Appeals, for the Tenth Circuit stated (147 F. 2d at 966):

> While advance royalties are regarded as income to the lessor, with respect to the lessee, they represent cost and are a capital expenditure. There is no incongruity in the view that a bonus and royalty are "consideration for the lease, and are income of the lessor." *Burnet* v. *Harmel, supra,* 287 U. S. 103 at page 112, * * '.

The lessee of an oil and gas lease receives a percentage depletion deduction on its gross income other than the advance and annual royalties it pays to the lessor, but that fact is immaterial so far as the present case is concerned. Oil and gas leases are exhaustible assets, whereas taxpayers license was not.

B. The Dobson doctrine does not preclude this Court from determining that the $1,000,000 in notes did not represent the sale price of a capital asset

The Tax Court included in its findings of fact a finding that "This transaction [the exercise by Seattle of its option] constituted the sale and acquisition of a capital asset" (R. 53) but, as we will show, this finding resulted from the view, already shown to be erroneous, that Rainier necessarily made a "sale" merely because Seattle acquired a capital asset in the transaction. The Tax Court's finding that there was a "sale" does not in any event preclude review by this Court, as will be seen.

As we showed in our brief in the Seattle case, No. 11467, Seattle did in fact make a capital investment and acquire a capital asset or something in the nature of a capital asset for which it paid $1,000,000 when on July 1, 1940, it exercised its option under the the April 23, 1935, agreement and delivered to Rainier the five promissory notes totalling $1,000,000. Seattle's acquisition of the capital asset, which consisted of a limited right to use the trade name "Rainier", etc., did not depend upon whether a "sale" resulted from Seattle's exercise of its option. The question in the *Seattle* case was simply whether Seattle was entitled to a business expense deduction for the $300,000 which accrued on the notes in 1940 and 1941; and, since the $300,000 was part of the total $1,000,000 capital investment and was paid for something of a permanent nature whose value remained constant and whose cost therefore could not be allocated over any given number of years, the $300,000 was not deductible as a business expense even though it constituted an advance lump sum royalty for a license. An argument to that effect was made in the Tax Court by the Commissioner, was adopted by the Tax Court in its opinion in the *Seattle* case (see R. 58–59, 60, 71, No. 11467), but apparently without a clear understanding of its effect, and fully sustained the Tax Court's ultimate conclusion in the *Seattle* case that "upon the exercise of the option petitioner [Seattle] acquired a capital asset for which it paid $1,000,000" (R. 72, No. 11467).

Nevertheless, the Tax Court's decision in the present case is based upon its decision in the *Seattle* case and in both cases the Tax Court assumed that, because Seattle made a capital investment and acquired a capital asset, a sale necessarily resulted from Seattle's exercise of the option. In the *Seattle* case the Tax Court stated that (R 54, No. 11467)—

> The question, therefore, turns on whether the sum of $1,000,000 is to be regarded as an expense in the nature of prepaid royalties or whether it is to be regarded as a capital expenditure. * * *

and in the remainder of the opinion went on to discuss the provisions of the April 23, 1935, agreement and the pertinent decisions in the light of the question whether Seattle acquired a license or there was a sale (R. 54–72, No. 11467), the Tax Court's theory apparently being that Seattle made a capital expenditure only if the exercise of its option in 1940 resulted in a sale. The Tax Court was not required to and did not specifically hold that there was a sale, but it did state ultimately that "This was a capital transaction" (R. 72, No. 11467), which of course it was as to Seattle but not necessarily as to Rainier.

In its decision in the present case the Tax Court stated that the first issue is whether the $1,000,000 in notes received by Rainier from Seattle was ordinary income and then, as in its decision in the *Seattle* case, states (R. 61):

> The question turns on whether the sum of $1,000,000 is to be regarded as prepaid royalties, or whether it is to be regarded as an expenditure in the acquisition of a capital asset.

Thus again the Tax Court failed to recognize that the $1,000,000 could constitute prepaid royalties and still be an expenditure in the acquisition of a capital asset. This error is further, and fatally, perpetuated in the opinion in the present case, which, on the first issue, consists only of a statement that the issue "is governed" by the decision in the *Seattle* case (R. 61); a quotation from the decision in the *Seattle* case which concludes with the statement that "upon the exercise of the option petitioner [Seattle] acquired a capital asset for which it paid $1,000,000" (R. 62); and another statement that "Upon the authority of" the *Seattle* decision the $1,000,000 was not ordinary income to Rainier (R. 62).

Thus, the Tax Court's failure to recognize that Seattle's acquisition of a capital asset was not conclusive of the nature of the $1,000,000 in the hands of Rainier obviously colored the Tax Court's factual conclusion that there was a "sale." Only ostensibly, and not even specifically, did the Tax Court determine that the $1,000,000 constituted the sale price of a capital asset rather than an advance lump-sum royalty, for a "sale" to the Tax Court meant the acquisition of a capital asset by Seattle and Seattle obviously did acquire a capital asset.

However, this Court's power to review the issue and reverse the Tax Court's decision is not limited in any way even if full effect is given to the Tax

Court's finding that there was a sale. There is no factual question here as to the intent of the parties (as in *Choate* v. *Commissioner,* 324 U. S. 1) or as to whether title passed in the transaction. The intent of the parties is uncontrovertibly evident from the written agreement itself and the Tax Court in no way intimated that the parties' intent might have been different from the intent expressed in the agreement. As will be seen, it is plain from the agreement, and therefore undisputed, that Rainier retained the right to use the trade-marks "Rainier" and "Tacoma" on beer, ale, and other alcoholic malt beverages outside of Washington and Alaska and to use the trade-marks on nonalcoholic beverages within Washington and Alaska, and was to maintain the registration of the trade-marks in Washington and Alaska, and that Seattle, after as well as before the exercise of its option in 1940, had only the limited right to use the trade-marks in Washington and Alaska, to use them in those areas only in connection with the manufacture and sale of beer, ale and other alcoholic malt beverages, and could not assign or license even those limited rights without Rainier's consent. The question in the case is whether these undisputed facts establish a "sale of capital assets" within the meaning of Section 117 of the Internal Revenue Code. Since its decision in *Dobson* v. *Commissioner,* 320 U. S. 489, the Supreme Court has frequently determined whether the facts found by the Tax Court come within the meaning of statutory language, as the Supreme Court itself recognized in *Trust of Bingham* v. *Commissioner,* 325 U. S. 365, where it stated (p. 371):

> Since our decision in the *Dobson* case we have frequently reexamined, as matters of law, determinations by the Tax Court of the meaning of the words of a statute as applied to facts found by that court. * * *

For this statement the Court cited sixteen of its decisions. To these may be added *Trust of Bingham* v. *Commissioner, supra; Crane* v. *Commissioner,* decided April 14, 1947 (1947 P–H, par. 72,004); *McWilliams* v. *Commissioner,* decided June 16, 1947 (1947 P–H, par. 72,007). As the Supreme Court stated in the *Trust of Bingham* v. *Commissioner, supra,* pp. 371–372, questions whether the facts found come within the meaning of the statutory language—

> are therefore questions of law, decision of which is unembarrassed by any disputed question of fact or any necessity to draw an inference of fact from the basic findings. See *Commissioner* v. *Scottish American Investment Co., supra.* They are "clear cut" questions of law, decision of which by the Tax Court does not foreclose their decision by appellate courts, as in other cases. * * *
>
> * * * * *
>
> * * * the statute [authorizing determination of whether decisions of the Tax Court are "in accordance with law"] does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. * * *

The *Dobson* case itself is authority for the proposition that only a question of law is presented when the question is whether the undisputed facts establish a "sale of a capital asset" within the meaning of Section 117. In two of the four cases covered by the first *Dobson* decision there was a petition for rehearing on which the Supreme Court filed an opinion. *Dobson* v. *Commissioner,* 321 U. S. 231. This decision is best stated in the language of the Supreme Court, which was as follows (pp. 231–232):

> In these two cases the Tax Court held that recoveries by these taxpayers in 1939 did constitute taxable income. It held, also, that the recovery was taxable as ordinary income, despite taxpayer's contention that it should be taxed as capital gain under § 117 of the Internal Revenue Code. This contention, the petition says, presents questions of law to be determined by this Court, rather than of fact finally to be determined by the Tax Court.
>
> The weakness of taxpayers' position lies in the fact that not every gain growing out of a transaction concerning capital assets is allowed the benefits of the capital gains tax provision. Those are limited by definition to gains from "the sale or exchange" of capital assets. Internal Revenue Code § 117 (2), (3), (4), (5). *We certainly cannot say that the items in question were as matter of law proceeds of the "sale or exchange" of a capital asset.* Harwick asserted a claim, and the three other taxpayers involved in these cases filed suit, against the National City Company, demanding rescission of their purchases of stock. Their claims were compromised or admitted; the taxpayers seek to link the recoveries resulting therefrom with their prior sales of the stock, which resulted

> in losses. The Tax Court did not find as matter of fact, and *we decline to say as matter of law, that such a transaction is a "sale or exchange" of a capital asset in the accepted meaning of those terms.* Cf. *Helvering* v. *Flaccus Leather Co.,* 313 U. S. 247; *Fairbanks* v. *United States,* 306 U. S. 436. * * * [Italics supplied.]

Thus, the Supreme Court did not deem itself bound by the Tax Court's decision as to whether on the facts there was a sale of capital assets; the facts were simply insufficient to establish a sale. In the present case the facts do furnish a basis for holding that, contrary to the Tax Court's conclusion, there was *not* a sale.

Moreover, regardless of what interpretation is placed upon the *Dobson* doctrine as enunciated in the first *Dobson* decision, 320 U. S. 489, the doctrine has never been construed as precluding review where there is no factual basis for the Tax Court's decision. This alone is sufficient basis for the reversal of the Tax Court's decision in the present case on the first issue.

C. Under the terms of the April 23, 1935, agreement Seattle acquired only a limited right to use Rainier's trade names "Rainier" and "Tacoma," etc.

The April 23, 1935, agreement between Seattle and Rainier makes it clear, and neither Rainier nor Seattle disputes the fact, that both before and after July 1, 1940, when Seattle exercised the option given it under paragraph Thirteenth of the agreement, Seattle had only a *limited* right to use the trade names "Rainier" and "Tacoma," etc., held by Rainier.

The "Purchase Agreement" part of the April 23, 1935, agreement related to the purchase by Seattle and the sale by Rainier of a plant in Seattle, Washington, which had not been used by Rainier as a brewery since 1915 but which after the repeal of prohibition in 1933 was used by Rainier as a warehouse and sales office for the distribution in the State of Washington of the products it manufactured at San Francisco, California (R. 39–41). Since Seattle was a "competing company" in the State of Washington, as the Tax Court found (R. 41), and consequently had a brewery of its own in that State, and since there is nothing in the record to indicate that Seattle needed additional facilities, the "Purchase Agreement" part of the agreement is of no significance for present purposes except for the fact that Rainier's Seattle plant, after its purchase by Seattle, was to stand as security for the performance by Seattle of its obligations under the contract.

The first paragraph of the "Licensing Agreement" provided as follows (R. 611–612):

> LICENSING AGREEMENT
>
> Seventh: Rainier hereby grants to Century the sole and exclusive perpetual right and license to manufacture and market beer, ale, and other alcoholic malt beverages within the State of Washington and the Territory of Alaska under the trade names and brands of "Rainier" and "Tacoma," together with the right to use within said State and Territory any and all copyrights, trade-marks, labels, or other advertising media adopted or used by Rainier in con-

> nection with its beer, ale, or other alcoholic malt beverages.

Thus, Seattle's license included not only the use of the trade names "Rainier" and "Tacoma" but the right to use any and all copyrights, trade-marks, labels, or other advertising media adopted or used by Rainier in connection with its beer, ale, or other alcoholic malt beverages. For convenience, the license will be referred to simply as a right or license to use the trade names "Rainier" and 'Tacoma." The license was limited geographically to the State of Washington and Territory of Alaska and even in that State and territory applied only in connection with the manufacture and sale of beer, ale, and other alcoholic malt beverages. Paragraph Ninth expressly provided (R. 614):

> It is understood and agreed, however that Rainier shall have the sole and exclusive right to manufacture, sell, and distribute *non-alcoholic* beverages within said territory under said trade names or brands of "Rainier" and "Tacoma" and any and all other trade names or brands that it owns and desires to use. [Italics supplied.]

Therefore, although Seattle's license was, as the parties stated, a "sole and exclusive * * * right and license" to manufacture and sell beer, ale, and other alcoholic beverages under the trade names "Rainier" and "Tacoma" in Washington and Alaska, the license was not sole and exclusive as to either that territory or as to its use in connection with beer, ale, and other alcoholic beverages. Rainier retained both the right to use the trade names in Washington and Alaska on nonalcoholic beverages and the right to use the trade names in states and territories other than Washington and Alaska on beer, ale, and other alcoholic malt beverages—the products on which it licensed Rainier to use the trade names in Washington and Alaska. The contract was even amended to permit Rainier to distribute its "Rainier Special Export" beer in Alaska so long as Seattle did not request that it discontinue such sales (R. 690). Seattle's license was further limited by the fact that the agreement specifically provided that Seattle could not assign any of its rights under the agreement without Rainier's consent (R. 625). Rainier, not Seattle, was to maintain registrations on the trade names both in Washington and Alaska (R. 614–615).

The agreement did not provide for any change in the scope of Seattle's license if it exercised its option and when it did exercise the option on July 1, 1940, all that occurred was that the lump-sum payments were substituted for the annual royalties which Seattle had been paying. Neither Rainier nor Seattle contends that Seattle's license was enlarged in scope by the exercise of the option. The option was simply a right after five years "of electing to terminate all royalties *thereafter* payable hereunder" [Italics supplied] (R. 619).

The only point on which Rainier and Seattle disagree in respect of the interpretation of the agreement is as to whether, after the exercise of its option, Seattle was bound by other provisions of the agreement which, if not fulfilled, might have resulted in a default and consequent forfeiture of the license. Rainier contended in the Tax Court that the agreement did not continue in effect after the exercise of the option, because the Seattle plant was to be security for the performance of Seattle's obligations under the agreement and paragraph Fifth provided for release of that security upon exercise of the option, and that, therefore, after the exercise of the option Rainier no longer had the right to terminate the agreement on default of its provisions by Seattle. (See, e. g., R. 135). Seattle, on the other hand, contended in the Tax Court and contends here that the contract did remain in effect and that its license was good for only such time as it continued to comply with the provisions of the agreement. The Tax Court in its opinion in the *Seattle* case, on which its decision in the present case was based, stated that it was doubtful whether the conditions of the agreement survived the exercise of the option but assumed that the conditions did survive the agreement and minimized their effect, stating that they were for the mutual benefit of both parties and that the forfeiture clause of the agreement was no longer operative *in a real sense* (R. 61–62, 66, No. 11467).

While we do not think that the resolution of this point is essential to a reversal of the Tax Court's decision, it should be noted that Rainier's position finds little, if any, support in the record. Certainly, there is no basis for Rainier's contention that the agreement did not remain in effect after the exercise of the option by Seattle, for the agreement not only contains no provision for its termination upon exercise of the option but Rainier itself treated the agreement as still effective. After the exercise of the option, Rainier, in consideration of the advance payment of two of the promissory notes given by Seattle, agreed that the territory described in the April 23, 1935, agreement "shall be enlarged so as to include the State of Idaho" (R. 705). Under the agreement Seattle was required, among other things, to purchase malt from Rainier and could not assign its rights under the agreement without Rainier's consent (R. 619–620, 625). Rainier treated these provisions as still effective after the exercise of the option by Seattle, for on November 25, 1942, Rainier wrote to Seattle stating (R. 709–710):

> Second. We have further, in consideration of your obtaining the advance payment of the two promissory notes hereinbefore referred to [the last two, Nos. 4 and 5], released and do hereby release Seattle Brewing & Malting Company and its successors in interest, of and from all past, present or future claims or obligations existing or arising out of the provisions of Paragraph XIV of the Miscellaneous provisions of said agreement of April 23, 1935, with reference to the purchase of malt.
>
> Third. We do further, in consideration of your obtaining the advance payment of the notes hereinbefore referred to, agree that the license granted by the terms of said agreement of April 23, 1935, and the amendment thereof dated April 13, 1942, extending the territory covered thereby to include the state of Idaho, shall be considered amended as to Paragraph XXIV of said agreement of April 23, 1935, so that the right to manufacture and sell beer under the

> trade names "Rainier" and "Tacoma" within the territories covered by said agreement may by the Seattle Brewing & Malting Company be extended to any plant or plants of any brewing company located within the states of Washington, Idaho or the Territory of Alaska of which the Seattle Brewing & Malting Company may be the owner or in control, this without the necessity of securing the written consent of the undersigned in connection therewith.

Rainier did not release Seattle from its other obligations under the agreement and, since Rainier regarded matters in the agreement as the proper subjects of release for a consideration, Rainier must necessarily also have considered Seattle's other obligations as remaining in effect after the exercise of the option. These included Seattle's obligations to maintain at all times the quality of its "Rainier" and "Tacoma" beer, ale and other alcoholic malt beverages at least equal to the quality of similar products manufactured and marketed under the trade-names by Rainier (R. 615); to increase the volume of "Rainier" and "Tacoma" beer sold in its territory so that it should be equal to the volume of sales of all other such products manufactured and sold by Seattle (R. 620); "as long as this agreement shall remain in force," to expend in advertising its "Rainier" and "Tacoma" products an amount per barrel equal and equivalent to the amount per barrel expended by it in advertising other beverages manufactured and sold by it under any and all other brands within the territory described in the agreement (R. 620); and to sell its surplus "Rainier" and "Tacoma" products to Rainier for sale outside Seattle's territory (R. 621). Obviously, these provisions were important to Rainier, which was selling "Rainier" and "Tacoma" beer in neighboring states and had the right to, and probably was, selling non-alcoholic beverages in Washington and Alaska under the trade names "Rainier" and "Tacoma." The maintenance of volume production, quality, and advertising by Seattle certainly was beneficial to Rainier and, conversely, the failure by Seattle to maintain volume production, quality, and advertising would have adversely affected Rainier's sales of products under the trade names. That no doubt was the reason for the inclusion of the provisions in the first place. Since they were part of the agreement and Rainier, as already shown, considered the agreement as remaining in effect after Seattle's exercise of its option, paragraph Twenty-Second of the agreement also remained in effect. That paragraph provided in part as follows (R. 624):

> Twenty-second: In the event that Century shall fail to fully and promptly carry out the terms and provisions of this agreement or to pay, in the manner and at the times herein provided, the payments herein agreed to be paid by it, and such failure continues for a period of thirty (30) days after written notice to it by Rainier, then and in that event, such failure shall be and become an event of default, and Rainier shall cancel this agreement by written notice to Century [Seattle]. Upon Rainier so notifying Century [Seattle] any and all rights

> of Century hereunder [Seattle] shall immediately terminate. * * *

After Seattle had paid off the $1,000,000 in promissory notes, a default could not occur by reason of Seattle's failure to pay, but paragraph Twenty-second, just quoted, also contemplated a default for failure "to fully * * * carry out the terms and provisions of this agreement" and such a default could obviously occur just as well after the execution of the option as before. The agreement does not state that either it or the default provision was to become ineffective upon exercise of the option. If the parties had intended that either should become ineffective, they could very easily have so stated in the agreement. Instead, the agreement makes no provision for a difference in Seattle's status after the exercise of the option except as to the amount of and time for the payments Seattle was to make for the license. In Washington particularly, Rainier of course still had a vital interest in the maintenance of the quality of "Rainier" and "Tacoma" beer by Seattle and in the advertising and maintenance of the volume of production, for Rainier sold "Rainier" beer in the neighboring State of Oregon and was entitled to, and may have, sold nonalcoholic beverages in Washington under the trade name "Rainier." Moreover, the very fact that Rainier had not given Seattle the right to assign its rights under the April 23, 1935, agreement shows that Rainier necessarily retained the reversion in Seattle's license and, of course, a reversion could occur only by reason of some failure on the part of Seattle.

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D. Seattle's acquisition of the limited right to use Rainier's trade names "Rainier" and "Tacoma," etc., did not constitute a transfer of "property" essential to a "sale"

It is axiomatic that a transfer of "property" is essential to a "sale" (*Ratigan* v. *United States,* 88 F. 2d 919, 921 (C. C. A. 9th), certiorari denied, 301 U. S. 705, rehearing denied, 302 U. S. 774) and the property right in a trade-mark has been well defined. As the Supreme Court recently stated in *Champion Spark Plug Co.* v. *Sanders,* decided by the Supreme Court April 28, 1947, referring to its opinion in *Prestonettes, Inc.* v. *Coty,* 264 U. S. 359—

> Mr. Justice Holmes stated, "A trade-mark only gives the right to prohibit the use of it so far as to protect the owner's good will against the sale of another's product as his. * * *"

Similarly, in *Hanover Milling Co.* v. *Metcalf,* 240 U. S. 403, 413, 414, it was stated that a trade-mark—

> is a property right but only in the sense that a man's right to the continued enjoyment of his trade reputation and the good will that flows from it, free from unwarranted interference by others, is a property right, for the protection of which a trade-mark is an instrumentality.
>
> * * * * *
>
> In short, the trade-mark is treated as merely a protection for the good will, and not the subject of property except in connection with an existing business. * * *

Again in *United Drug Co.* v. *Rectanus Co.,* 248 U. S. 90, 97, it was stated that—

> There is no such thing as property in a trade-mark except as a right appurtenant to an estab-

> lished business or trade in connection with which the mark is employed. * * * the right to a particular mark grows out of its use, not its mere adoption; its function is simply to designate the goods as the product of a particular trader and to protect his good will against the sale of another's product as his; and it is not the subject of property except in connection with an existing business. * * *

These decisions sufficiently establish that the only "property" in a trade-mark is the continued enjoyment and protection of the owner's trade reputation and good will—a type of "property" which necessarily follows the business itself.[6] As this Court stated in *California Packing Corp.* v. *Sun-Maid R. Growers,* 81 F. 2d 674, 678—

> A manufacturer cannot make a valid assignment of a trade-mark and continue the manufacture or sale of the same products in connection with which the trade-mark was used. *Eiseman* v. *Schiffer* (C. C.) 157 F. 473; *Independent Baking Powder Co.* v. *Boorman* (C. C.) 175 F. 448.

Assuming that good will is a capital asset within the meaning of the capital gains provisions, it nevertheless appears that in exercising its option Seattle did not acquire the "property" in or represented by the trade-marks "Rainier" and "Tacoma" and, accordingly, that the exercise of the option could not have resulted in a sale. Rainier remained in the

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[6] A trade-mark may be *licensed* when it remains associated with the same product. See *E. F. Prichard Co.* v. *Consumers Brewing Co.*, 136 F. 2d 512 (C. C. A. 6th), certiorari denied, 321 U. S. 763.

same business, continued to manufacture and sell "Rainier" beer, and had the right to use the trade-marks on non-alcoholic beverages in Washington and Alaska. The trade-marks and the protection of good-will and trade reputation which they represented remained attached to Rainier's business *after* the exercise by Seattle of its option, since Rainier did not sell its business to Seattle.[7] Thus, by the April 23, 1935, agreement, both before and after the exercise of the option, Rainier simply relinquished a part of the protection represented by the trade names; in other words, Rainier sanctioned a limited infringement by Seattle on Rainier's trade-mark rights. In a broad sense this might be regarded as a transfer of part of Rainier's good will, but Rainier's good will was not "property" unless it was transferred along with Rainier's business, which it was not. Thus, there was no actual transfer of the "property" represented by the trade-marks. Cf. *United States* v. *Fairbanks,* 95 F. 2d 794 (C. C. A. 9th), affirmed, 306 U. S. 436.

The transaction was similar to other transactions which have held to result in ordinary, rather than capital, income. In *Yost* v. *Commissioner,* 155 F. 2d 121 (C. C. A. 9th), the taxpayer, who was the majority stockholder in Tricoach, received lump sum payments as consideration for his consent to a discontinuance of Tricoach's business and a sale of its facilities to the Newells, the other two stockholders, who had an op-

[7] Rainier's business had been carried on from San Francisco for years. The Seattle, Washington, plant it sold to Seattle was used merely for storage and as a distribution center.

portunity for employment with the American Car and Foundry if they could obtain the facilities of Tricoach. The purchase price of the facilities was paid by the Newells to Tricoach and Tricoach then distributed the proceeds to the stockholders, according to their respective interests, under an agreement that the distributions would be returned if Tricoach resumed business. The taxpayer, who had received the lump-sum payments for his consent to the discontinuance of business and the sale to the Newells, still retained his stock, which gave him power to demand the return of the distributed funds if Tricoach resumed business. He contended that the transaction of the sale of the plant facilities was a liquidation of the corporate assets by which the stock he owned had been merged into the promises of the Newells to pay the consideration for his consent and vote for the sale. This Court held that the stock was still owned by the taxpayer and had not been sold or exchanged within the meaning of Section 117 of the Internal Revenue Code and that the money the taxpayer received from the Newells for his agreement to consent and vote for the sale of the facilities of Tricoach and not to continue in business was ordinary, not capital, income. In the instant case Rainier too had merely consented to something for a consideration but retained the ownership of that which could have been the subject of sale. In *Hale* v. *Helvering,* 85 F. 2d 819 (App. D. C.), it was held that the compromise of notes which the maker was able to pay was not the sale of a capital asset. The Court there stated (p. 821):

> Neither business men nor lawyers call the compromise of a note a sale to the maker. *In point of law and in legal parlance property in the notes as capital assets was extinguished, not sold.* * * * [Italics supplied.]

Similarly, in the instant case Rainier's property as represented by the trade-marks "Rainier" and "Tacoma" was partially extinquished, not sold, under the April 23, 1935, agreement and Seattle's exercise of its option. Cf. *Helvering* v. *Flaccus Leather Co.,* 313 U. S. 247.

United States v. *Adamson,* decided by this Court on May 16, 1947 (1947 P–H, par. 72,474), is not in conflict with our position here. In that case it was held that the taxpayer had made a sale of capital assets in transferring his undivided one-half interest in partnership assets which included two contracts of sale involving patent and trade-mark rights. The taxpayer had been a partner with his brother and the two contracts of sale had originally been executed by the partnership and the partnership later repudiated by the other brother. The taxpayer, after obtaining a judgment that he had a one-half undivided interest in all of the assets of the partnership, entered into a four-party contract whereby, for a consideration payable in installments, he transferred his entire interest in the partnership assets, which included his interest in the two contracts of sale and any interest he may have had in the patent and trade-mark. The holding that the taxpayer had made a sale of capital assets was based primarily on the fact that he had made a transfer of all of his interest in the remaining assets of the partnership. The Court was not required to determine whether the two contracts of sale were sales rather than licenses.

E. Even assuming that the transaction between Rainier and Seattle was a transfer of "property," the result was nevertheless a license and not a sale

As the Tax Court recognized (R. 60, No. 11467), a lump sum payment does not necessarily imply a sale as distinguished from a license. While a royalty is usually paid at a specified rate and periodically, a lump sum payment may also be a royalty if it is paid by a licensee to a licensor for the use of something. *Rohmer v. Commissioner,* 153 F. 2d 61 (C. A. A. 2d), certiorari denied, 328 U. S. 862; *Sabatini* v. *Commissioner,* 98 F. 2d 753 (C. A. A. 2d); *Hazeltine Corp.* v. *Zenith Radio Corp.,* 100 F. 2d 10, 16–17 (C. A. A. 7th). As the Circuit Court of Appeals for the Tenth Circuit stated in *Commissioner* v. *Affiliated Enterprises,* 123 F. 2d 665, 668—

> While payment ordinarily is at a certain rate for each article or certain percent of the gross sale, that in itself is not determinative. *The purpose for which the payment is made and not the manner thereof is the determining factor.* [Italics supplied.]

To the same effect, see *Rohmer* v. *Commissioner, supra.*

Seattle's right to the use of the trade-marks "Rainier" and "Tacoma" was not enlarged by the exercise of its option and execution of the five promissory notes aggregating $1,000,000. The promissory notes, or lump sum payments, were merely a substitute for the annual payments on a barrelage basis previously paid by Seattle and, since those annual payments were considered to be and were in fact royalties for a license, the lump sum obligations also represented royalties. In *Hort* v. *Commissioner,* 313 U. S. 28, Hort, who had received $140,000 in consideration for the cancellation of a lease of premises, contended that the $140,000 was capital rather than ordinary income. The Supreme Court, after stating that Section 22 (a) defines gross income as including rent, continued as follows (pp. 30–32):

> Plainly this definition reached the rent paid prior to cancellation just as it would have embraced subsequent payments if the lease had never been canceled. It would have included a prepayment of the discounted value of unmatured rental payments whether received at the inception of the lease or at any time thereafter. Similarly, it would have extended to the proceeds of a suit to recover damages had the Irving Trust Co. breached that lease instead of concluding a settlement. * * * That the amount petitioner received resulted from negotiations ending in cancellation of the lease rather than from a suit to enforce it cannot alter the fact that *basically the payment was merely a substitute for the rent reserved in the lease.* * * *
>
> The consideration received for cancellation of the lease was not a return of capital. We assume that the lease was "property," whatever that signifies abstractly. * * * *Where, as in this case, the disputed amount was essentially a substitute for rental payments which § 22*

> (*a*) *expressly characterizes as gross income, it must be regarded as ordinary income,* and it is immaterial that for some purposes the contract creating the right to such payments may be treated as "property" or "capital."
>
> *   *   *   *   *
>
> The cancellation of the lease involved nothing more than relinquishment of the right to future rental payments in return for a present substitute payment and possession of the leased premises. * * * [Italics supplied.]

While the parties' conception of the legal effect of a transaction is not controlling, it is at least significant that Rainier itself apparently assumed that Seattle had nothing more than a license after the exercise of the option by Seattle and that the promissory notes aggregating $1,000,000 constituted a lump-sum royalty. Under date of July 1, 1940, the president of Rainier called a special meeting (1) to consider a recent proposal submitted by Seattle and approving the action of the officers of Rainier in relation thereto (R. 741) and (2) to consider and, if advisable, take action upon any and all matters relating to the tender by Seattle of its promissory notes aggregating $1,000,000 "for a perpetual license" to use the trade names "Rainier" and "Tacoma" in the State of Washington and Territory of Alaska and to accept those notes as consideration therefor (R. 742). On the following day, at the special meeting so called, the board of directors of Ranier adopted a resolution authorizing its officers to accept the five promissory notes aggregating $1,000,000 pursuant to the provisions of paragraph Thirteenth of the agreement (R. 743–744) and, with respect to the proposal submitted by Seattle and referred to in the notice of the meeting, adopted a resolution approving the action of its officers and executive committee in refusing to accept the proposal of Seattle, which was to amend the April 23, 1935, agreement so as to provide for the payment of Seattle of $400,000 in cash before January 2, 1941, and the execution of promissory notes aggregating $600,000 payable over a period of five years in consideration of Rainier's granting Seattle "a perpetual license" to manufacture and sell its products under the trade names "Rainier" and "Tacoma" *in Oregon and Idaho* "without further consideration or payment of royalties" (R. 742–743). Later, on April 11, 1942, Seattle offered to pay in April 1942, the two notes due July 1, 1942, and July 1, 1943, if Rainier would give Seattle a letter adding the State of *Idaho* to the agreement of April 23, 1935 (R. 703–704). In answer Rainier wrote referring to the April 23, 1935, agreement and stating as follows (R. 705–706):

> In consideration of your paying the principal and interest to date of payment of your two promissory notes, each in the principal sum of $200,000, and payable to the undersigned on July 1, 1942, and July 1, 1943, respectively, it is agreed that the territory described in the agreement shall be enlarged so as to include the State of Idaho, and you are hereby granted, subject to all the terms and provisions of the agreement, the sole and perpetual *right and license*

> to manufacture and market beer, ale, and other alcoholic malt beverages within the State of Idaho under the trade names and brands of "Rainier" and "Tacoma," *without the payment of any royalty therefor other than the payment of the remaining promissory notes heretofore given by the Seattle Brewing & Malting Company in settlement of all royalty payments under said agreement of April 23, 1935.* The undersigned hereby expressly reserves the right to manufacture and/or market beer, ale, and other alcoholic malt beverages within the State of Idaho under trade names and brands other than "Rainier" and "Tacoma." [Italics supplied.]

William F. Humphrey, who was formerly the general counsel of Rainier (R. 418–419), participated in the negotiations leading up to the execution of the April 23, 1935, agreement (R. 419) and appeared before the Tax Court on Rainier's behalf, testified that when they discussed the question of royalties during the negotiations (R. 425)—

> it was suggested that then they [Seattle] would want to, after five years have the right or some period of time, *the right to acquire perpetual royalties.* [Italics supplied.]

There was some evidence that Seattle's option was regarded as a right to purchase but this evidence was inconsequential. It consisted of a reference by Dun & Bradstreet to the exercise of the option as a purchase (R. 818); a newspaper account, supposedly attributable to the president of Seattle, that Seattle was privileged to make an outright purchase for $1,000,000

(R. 483); and a statement in Rainier's annual statement for 1940 that the $1,000,000 "was received in consideration of the sale of certain intangible assets" (R. 810).

In any event, assuming that "property" was involved in the transaction between Rainier and Seattle, no sale resulted from the exercise of the option by Seattle. To constitute a sale, there must be a transfer of the *absolute and general property* in a thing (*Butler* v. *Thomson,* 92 U. S. 412, 415; *In re Grand Union Co.,* 219 Fed. 353, 356 (C. C. A. 2d), certiorari denied *sub nom. Hamilton Inv. Co.* v. *Ernst,* 238 U. S. 626, and appeal dismissed, 238 U. S. 647) or, as sometimes stated, a transfer of title (*Hale* v. *Helvering,* 85 F. 2d 819, 821 (App. D. C.); *Sabatini* v. *Commissioner,* 98 F. 2d 753 (C. C. A. 2d); *MacDonald* v. *Commissioner,* 76 F. 2d 513, 514 (C. C. A. 2d); *Palmer* v. *Jordan Mach. Co.,* 186 Fed. 496, 512 (N. D. N. Y.), modified, 192 Fed. 42 (C. C. A. 2d); *De Bary* v. *Dunne,* 172 Fed. 940, 942 (D. Ore.)). The rights Seattle received were exceedingly limited, as we have already shown, and Seattle obviously did not receive the absolute and general property in anything as a result of the exercise of its option. Rainier retained the use of the trade names "Rainier" and "Tacoma" except in connection with alcoholic malt beverages sold in Washington and Alaska, and retained the protection of its good will and trade reputation represented by those trade-marks except for the limited infringement it authorized by Seattle. Seattle did not receive the right to assign its limited rights and even the Tax Court recognized

(R. 62, No. 11467) that "The right of alienation is one of the essential incidents of a right of property." The transaction was therefore not converted into a sale by Seattle's exercise of its option. See *Smith* v. *Dental Products Co.,* 140 F. 2d 140 (C. C. A. 7th).

It is not a valid argument to say that a "license" may in a loose sense be deemed a "sale." A "sale" within the meaning of the capital gains provisions of the Internal Revenue Code means a transaction which qualifies legally as a "sale" and is commonly understood to be encompassed by that word. *Hale* v. *Helvering,* 85 F. 2d 819, 822 (App. D. C.) A lease has been held by the Supreme Court not to constitute a "sale" for tax purposes and there is no more reason for assuming that a license should be deemed a sale. In *Burnet* v. *Harmel,* 287 U. S. 103, the taxpayer, the owner in fee of Texas oil lands, executed oil and gas leases of the lands for three years and as long thereafter as oil or gas should be produced from them by the lessee, in return for bonus payments aggregating $57,000 in cash and stipulated royalties measured by the production of oil and gas by the lessee. The Court noted that under Tax law an oil and gas lease operates immediately upon its execution to pass the title of the oil and gas in place to the lessee, but nevertheless held that the bonus payments aggregating $57,000 constituted ordinary income, not gain from the sale or exchange of a capital asset. Among other things, the Court stated (pp. 107, 112):

> Moreover, the statute speaks of a "sale," and these leases would not generally be de-

scribed as a "sale" of the mineral content of the soil, using the term either in its technical sense or as it is commonly understood. Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas. By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill, and produce oil and gas, if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, rather than a sale of the land or of any interest in it or in its mineral content. [Citing cases.]

* * * * *

Bonus and royalties are both consideration for the lease, and are income of the lessor. *We cannot say that such payments by the lessee to the lessor, to be retained by him regardless of the production of any oil or gas, are any more to be taxed as capital gains than royalties which are measured by the actual production.* * * * [Italics supplied.]

Similarly, in *Bankers Coal Co.* v. *Burnet,* 287 U. S. 308, it was held that stipulated royalties received for the assignment of a lease of coal lands were ordinary income, not the sale price of capital assets, despite the fact that under state law title to the coal in place passed to the lessor immediately upon execution of the lease. See also, *Esperson* v. *Commissioner,* 127 F. 2d 370, 372 (C. C. A. 5th); *Hogan* v. *Commissioner,* 141 F. 2d 92 (C. C. A. 5th), certiorari denied, 323

U. S. 710; *West* v. *Commissioner,* 150 F. 2d 723 (C. C. A. 5th), certiorari denied, 326 U. S. 795.

In these cases the lump sum payment, or advance royalty, was regarded as ordinary income in a situation where the lessor had merely retained some *economic* interest in the oil or gas or coal in place. Had there been an outright sale of the mineral interests; that is, a transfer of the absolute and general property in the oil and gas, the transaction would have been treated as a sale and the lump-sum payment the sale price. *Anderson* v. *Commissioner,* 81 F. 2d 457 (C. C. A. 10th).

In the present case, as in these other cases, Rainier retained an economic interest in (and also legal title to) the trade-marks "Rainier" and "Tacoma," and the arrangement with Seattle, instead of constituting a transfer of the absolute and general property represented by those trade-marks, was the grant of a right to a limited use of the trade-marks and hence a license. It is no answer to say that in the present case Seattle received an *exclusive* right within certain limits, for the lessor in these lease cases also had a separately identifiable interest—the certain percentage of the oil and gas in place represented by the retention of annual royalties.

The decisions involving copyrights are also pertinent. The bundle of rights conferred by a copyright includes motion picture, radio, book publishing, magazine and serial, etc., rights and these may be separately granted by the owner. It is well settled, however, that the grant of less than the entire bundle of rights is the grant of a license and not a sale. *Rohmer* v. *Commissioner,* 153 F. 2d 61 (C. C. A. 2d), certiorari denied, 328 U. S. 862; *Sabatini* v. *Commissioner,* 98 F. 2d 753 (C. C. A. 2d); Judge Chase's opinion in *Goldsmith* v. *Commissioner,* 143 F. 2d 466 (C. C. A. 2d), certiorari denied, 323 U. S. 774; *M. Witmark & Sons* v. *Pastime Amusement Co.,* 298 Fed. 470 (E. D. S. Car.), affirmed, 2 F. 2d 1020 (C. C. A. 4th); *Goldwyn Pictures Corp.* v. *Howells Sales Co.,* 282 Fed. 9 (C. C. A. 2d), certiorari denied, 262 U. S. 755; *New Fiction Pub. Co.* v. *Star Co.,* 220 Fed. 994 (S. D. N. Y.); *Estate of Alexander Marton* v. *Commissioner,* 47 B. T. A. 184; cf. *Ehrlich* v. *Higgins,* 52 F. Supp. 805 (S. D. N. Y.). The reason, as stated in *Goldwyn Pictures Corp.* v. *Howells Sales Co., supra,* p. 11, is that the assignee or licensee, no matter what he is called, of, for example, the dramatic motion picture rights under a copyright, does not own the copyright and owns less than the whole. The consideration for one or more, but less than all, of the bundle of rights is considered a royalty for tax purposes even though received in a lump sum (*Rohmer* v. *Commissioner, supra; Sabatini* v. *Commissioner, supra*) and even though the grant is unlimited as to time (*Rohmer* v. *Commissioner, supra*). The property rights in a trade-mark are not subject to separation as readily as the property interests in a copyright, and indeed, as we have shown, the only "property" there is in a trade-mark attaches to the business whose good will and trade reputation it protects, but, assuming that the trade-mark may be separated into property rights, these copyright cases plainly support the conclusion that there is no sale when less than the whole trade-mark is relinquished.

The trade-mark cases relied upon by the Tax Court are distinguishable. In *Andrew Jergens Co.* v. *Woodbury, Inc.,* 273 Fed. 952 (D. Del.), affirmed *per curiam,* 279 Fed. 1016 (C. C. A. 3d), certiorari denied, 260 U. S. 728, it was held that the grant of a trade-mark was "an assignment" rather than a license, but the grant of the trade-mark was absolute and complete in all respects except insofar as the assignor had heretofore given conflicting rights to other persons or corporations and except that the assignee was to have the right to use the trade-mark only so long as it continued in active business. Title quite plainly passed, subject to divestment by the happening of a condition subsequent—the discontinuance of active business by the assignee. *The Coca-Cola Bottling Co.* v. *The Coca-Cola Co.,* 269 Fed 796 (D. Del), involved an assignment to a prospective Coca-Cola bottler of the right to use Coca-Cola trade-marks. The only real question in the case was whether the contract of assignment was terminable at will by the parent company. In *Griggs, Cooper & Co.* v. *Erie Preserving Co.,* 131 Fed. 359 (W. D. N. Y.), there was a territorial and limited grant of trade-mark rights which were held sufficient to entitle the assignee's successor to maintain a suit for infringement of the trade-mark. The court did not state that there had been a sale of the trade-marks.

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F. Assuming that what Seattle received was "property" and that there may properly be a "sale" of less than the absolute and general property in a thing, the transaction between Rainier and Seattle still does not qualify as a "sale"

The Tax Court recognized that the grant of the exclusive use of a trade name in a limited territory does not dispose of the entire property in the grantor (R. 70–71, No. 11467) but apparently thought that such a grant might constitute a sale as being the equivalent of complete disposition within the limited territory granted. Except for the three trade-mark cases we have already distinguished, *supra,* and one other case which is easily distinguished,[8] the other decisions relied upon by the Tax Court consist of the opinion of Judges Learned Hand and Swan in *Goldsmith* v. *Commissioner,* 143 F. 2d 466 (C. C. A. 2d), certiorari denied, 323 U. S. 774, a copyright case in which it was immaterial whether there was a sale or a license, and several patent cases.

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[8] *Jefferson Gas Coal Co.* v. *Commissioner,* 52 F. 2d 120 (C. C. A. 3d), involved the question whether an agreement was a contract of sale of coal lands or a lease. Under the agreement the assignee was obligated to make ten annual payments to the assignor on the basis of twelve cents a ton on a minimum tonnage amounting to $31,000, together with all taxes: if the minimum tonnage was not mined, the assignee was nevertheless to pay the twelve cents a ton on the minimum tonnage until the expiration of the so-called lease; if the assignee mined more than the minimum tonnage the assignee was to pay for the excess at twelve cents a ton and this excess would be credited on the total payments of $310,000 ($31,000 for ten years) ; and when the last payment was made the assignor was to deliver to the assignee, its successors and assigns, a fee simple title to the unmined coal in and under the coal lands in question. Since the assignee was required to pay the $310,000 within the ten years irrespective of whether it mined any coal, the agreement was construed as a contract of sale rather than a lease.

By statute a transfer of less than the whole patent may be the subject of sale. As the Supreme Court stated in *Waterman* v. *Mackenzie,* 138 U. S. 252, 255—

> Every patent issued under the laws of the United States for an invention or discovery contains "a grant to the patentee, his heirs and assigns, for the term of seventeen years, of the exclusive right to make, use, and vend the invention or discovery throughout the United States and the Territories thereof." Rev. Stat. § 4884. The monopoly thus granted is one entire thing, and cannot be divided into parts, except as authorized by those laws. The patentee or his assigns may, by instrument in writing, assign, grant and convey, either, *1st, the whole patent, comprising the exclusive right to make, use, and vend the invention throughout the United States*; or, *2d, an undivided part or share of that exclusive right;* or, *3d, the exclusive right under the patent within and throughout a specified part of the United States.* Rev. Stat. § 4898. A transfer of either of these three kinds of interests is an assignment, properly speaking, and vests in the assignee a title in so much of the patent itself, * * *. *Any assignment or transfer, short of one of these, is a mere license, giving the licensee no title in the patent*, and no right to sue at law in his own name for an infringement. Rev. Stat. § 4919; * * * In equity, as at law, when the transfer amounts to a license only, the title remains in the owner of the patent; * * * [Italics supplied.]

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See also, *Moore* v. *Marsh,* 7 Wall. 515; *Littlefield* v. *Perry,* 21 Wall. 205; *Excelsior Wooden Pipe Co.* v. *City of Seattle,* 117 Fed. 140 (C. C. A. 9th).

In *tax* cases which have involved the question whether there was a sale or license of a patent, the agreement involved was interpreted as transferring the full and complete title *to the whole patent,* in some cases on condition subsequent. *Commissioner* v. *Celanese Corp.,* 140 F. 2d 339 (App. D. C.); *General Aniline & Film Corp.* v. *Commissioner,* 139 F. 2d 759 (C. C. A. 2d); *Commissioner* v. *Hopkinson,* 126 F. 2d 406 (C. C. A. 2d); *Rotorite Corp.* v. *Commissioner,* 117 F. 2d 245 (C. C. A. 7th);[9] *Myers* v. *Commissioner,* 6 T. C. 258; cf. *Boesch* v. *Graff,* 133 U. S. 697; *Rude* v. *Westcott,* 130 U. S. 152; *Federal Laboratories, Inc.* v. *Commissioner,* 8 T. C. No. 132. Hence, the Tax Court was in error in the present case in supposing, for example, that *Commissioner* v. *Celanese Corp., supra,* supports the conclusion that there was a sale, not a license. In the *Celanese Corp.* case full title to the patent for the entire United States and its territories passed to the assignee on a condition subsequent. The condition subsequent, which consisted of the provisions under which the assignee might lose the patent, were stated not to affect the intent and purpose of the contract "to vest immediately in the Purchaser absolute title to the patents," as the Tax Court's quotation from the decision (R. 65, No. 11467) shows.

Parke, Davis & Co. v. *Commissioner,* 31 B. T. A. 427, relied upon by the Tax Court here (R. 63, No.

[9] In this case annual royalty payments were to apply on the purchase price at the taxpayer's option.

11467), there was a sale of an *undivided* interest in patents. In that case the assignor granted to the assignee the unqualified right to the patents and the assignor retained the same unqualified right to the patents, both parties agreeing not to sell the patents or license others to use them. The Tax Court stated that while the naked legal title remained in the assignor, in whose name infringement suits might be brought, such suits were to be for the benefit of both parties and their costs borne equally by both, and further, that the assignor had billed the assignee for, and the assignee had paid, one-half of all costs in respect of the perfecting of the patent applications and the filing of additional applications for patent. As the Tax Court stated in *Myers* v. *Commissioner, supra,* the decision in the *Parke, Davis & Co.* case was a holding that there was a sale of a one-half interest in the patents. But see *Federal Laboratories, Inc.* v. *Commissioner*, 8 T. C. No. 132, where it was stated that the grant of the entire interest in the patent is a license, not a sale, where the agreement provides that the grantor retains legal title.

While there may be a sale of the exclusive right under a patent within and throughout a specified part of the United States, as distinguished from the sale of an undivided interest in the whole, a license and not a sale results if the entire and exclusive interest for that territory is not granted to the assignee. This is clear from the decision in *Waterman* v. *Mackenzie, supra,* in which it was stated that there could be such a sale but in which the agreement was not limited territorially. In that case it was held that the agreement involved constituted a license rather than an assignment because the assignee received the "sole and exclusive" right *to manufacture and sell* fountain penholders containing the patented improvement but did not receive the right *to use* such penholders, at least if manufactured by third persons. (P. 257.) As the Supreme Court stated (p. 256)—

> the grant of an exclusive right under the patent within a certain district, which does not include the right to make, and the right to use, and the right to sell, is not a grant of a title in the whole patent right within the district, and is therefore only a license. Such, for instance, is a grant of "the full and exclusive right to make and vend" within a certain district, reserving to the grantor the right to make within the district, to be sold outside of it. *Gayler* v. *Wilder,* above cited. So is a grant of "the exclusive right to make and use," but not to sell, patented machines within a certain district. *Mitchell* v. *Hawley,* 16 Wall. 544. So is an instrument granting "the sole right and privilege of manufacturing and selling" patented articles, and not expressly authorizing their use, because, though this might carry by implication the right to use articles made under the patent by the licensee, it certainly would not authorize him to use such articles made by others. *Hayward* v. *Andrews,* 106 U. S. 672. See also *Oliver* v. *Rumford Chemical Works,* 109 U. S. 75.

In *United States* v. *Gen. Elec. Co.,* 272 U. S. 476, 489, the Supreme Court reiterated substantially the same language. *Excelsior Wooden Pipe Co.* v. *City of Seattle,* 117 Fed. 140, decided by this Court, is a case similar to *Waterman* v. *Mackenzie, supra.* In that case this Court held that, because the grant was not complete, there was a license and not a sale of patent rights within certain described territory, which included the State of Washington.

Thus, while there may be a sale of an absolute undivided interest in the whole patent for the entire United States and its territories or a sale of the absolute interest in the patent for a given territory, the transfer of either an undivided or a territorial interest must be absolute and confer complete ownership of that interest in order to constitute a sale. In the present case there was, of course, no transfer of an undivided interest in the trade-marks "Ranier" and "Tacoma"; the only question which could arise in view of these patent cases is whether there was a transfer of absolute and complete ownership of the trade-marks within and throughout Washington and Alaska.

Seattle did not, of course, receive absolute and complete ownership of the trade-marks "Rainier" and "Tacoma" within and throughout Washington and Alaska. It received the right to use those trade-marks in Washington and Alaska only in the manufacture and sale of beer, ale, and other alcoholic malt beverages, Rainier retaining the right to use the trade-marks in the same territory on nonalcoholic beverages. A sale connotes a title or interest which is transferable and Seattle not only did not have the right to transfer the right to use the trade-marks in Washington and Alaska but could not even transfer its own limited right to use the trade-marks on alcoholic malt beverages. While Rainier, on the other hand, had given Seattle an exclusive right to use the trade-marks in Washington and Alaska in connection with the manufacture and sale of alcoholic malt beverages, Rainier still had control over the trade-marks in Washington and Alaska for use in connection with the manufacture and sale of nonalcoholic beverages and Rainier, not Seattle, was to maintain the registrations on the trade-marks in Washington and Alaska. Seattle's rights were also probably forfeitable, as we have already indicated, but, whether they were or not, what Seattle received from Rainier was a far cry from the absolute transfer of title for a particular area involved in the patent cases. As in the case of the patents involved in *Waterman* v. *Mackenzie, supra,* and *Excelsior Wooden Pipe Co.* v. *City of Seattle, supra,* Seattle did not receive all of the rights in the trade-marks in a particular area and the transaction between Rainier and Seattle therefore resulted in a license, not a sale.

We know of no authorities which even indicate that there may be a sale of less than complete ownership for a given territory as to any type of property, but assuming that there could be a sale of trade-mark rights for a specified territory for a limited purpose, as distinguished from all purposes, the transaction between Rainier and Seattle still would not qualify as a sale. In order to constitute a sale, the transfer of rights for the specified territory for the limited purpose would have to confer complete ownership on the transferee in respect of the trade-mark rights for that territory and purpose and, since Seattle did not receive the power to license or sublicense, or otherwise to transfer to others the rights it received, it received nothing from Rainier which constituted ownership even if it be assumed that the forfeiture provisions were no longer effective after the exercise of the option or were mere conditions subsequent.

Goldsmith v. *Commissioner,* 143 F. 2d 466 (C. C. A. 2d), certiorari denied, 323 U. S. 774, a copyright case, is not in conflict. The taxpayer there had made an assignment of the exclusive motion-picture rights in a copyrighted play and the question was whether the consideration therefor received by the taxpayer was to be treated as ordinary income or gain from the sale of a capital asset. Judge Chase was of the opinion that the sums received by the taxpayer were royalties and taxable as ordinary income for that reason. Judges Learned Hand and Swan agreed that the sums received were taxable as ordinary income but differed from Judge Chase in their reasoning. They were of the opinion that the exclusive license granted by the taxpayer was "property," that "It does not unduly strain the meaning of 'sale' to make it include an exclusive license" (p. 468), and that the grant was a sale within the meaning of Section 117 of the Code. They concluded, however, that the sale was not of a capital asset, because the copyrighted play was held by the taxpayer for sale to customers in the ordinary course of his business as a playwright and therefore came within one of the express exceptions to the definition of a capital asset. Thus, as the same court later stated in *Rohmer* v. *Commissioner, supra,* p. 65, relative to the decision in the *Goldsmith* case—

> As the legal result was the same in that case, whichever of the two rationales was accepted, the choice of rationale could there have no practical effect. * * * .

The opinion of Judges Learned Hand and Swan in the *Goldsmith* case does not in any event support the conclusion that there was a sale in the present case. In the first place, we are there dealing with trademarks, as to which there are no separable property rights as in a copyright. But at any rate the holding in the *Goldsmith* case was with reference to an "exclusive" license which was truly exclusive. Unlike the present case, the grant used the words "grant and assign", as Judge Hand noted, and the grant was not limited territorially or in any other way except that it applied only to the motion picture rights. Unlike the present case, the taxpayer there specifically granted to the assignee the right to assign the motion picture rights to others and agreed to permit the assignee to use his name, for its own benefit and at its own risk and expense, to enjoin infringements of any of the rights granted and to recover damages for infringement. The decision therefore stands only for the proposition that there may be, under proper circumstances, a sale of one or more of the rights covered by a copyright.

II

Assuming that there was a sale, the full amount of obsolescence allowed by the Commissioner in 1918 through 1920, rather than the amount from which Rainier received a tax benefit, should be taken into account in adjusting Rainier's basis under Section 113 (b) (1) (B) of the Code

Assuming, contrary to our argument under Point I, *supra*, that the Tax Court was correct in concluding that the $1,000,000 Rainier received from Seattle was the sale price of a capital asset, a question is presented in connection with the determination of the amount of Rainier's gain from the so-called sale. Under Section 111 (a) of the Code (Appendix, *infra*) the gain is the excess of the amount realized ($1,000,000) over the adjusted basis provided in Section 113 (b) (Appendix, *infra*). Since Rainier held the trade names "Rainier" and "Tacoma" prior to March 1, 1913, its *unadjusted* basis is the March 1, 1913, value of the trade names for Washington and Alaska (Section 113 (a) (14), Appendix, *infra*), which the Tax Court found to be $514,142 (R. 59). Section 113 (b) (1) (B) requires that this amount be adjusted—

> (B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, * * * to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. * * *

As the Tax Court found (R. 60), Rainier filed a claim for abatement of taxes in 1919 based on a claim of obsolescence of good will due to the advent of prohibition. The claim was in the amount of $542,240.27, which represented Rainier's computation of its good will as of March 1, 1913. Pursuant to this claim, the Commissioner computed the March 1, 1913, value of Rainier's good will to be $406,680.20 and allowed Rainier obsolescence on that amount, allocating $345,061.95 to 1918; $59,153.48 to 1919; and $2,464.77 to 1920. By reason of this allowance, Rainier received a total tax benefit for obsolescence in the amount of $138,137.40. The Tax Court held that this amount, and not the full amount of obsolescence allowed, was to be taken into consideration in arriving at Rainier's adjusted basis for the so-called sale of the trade names "Rainier" and "Tacoma" to Seattle; that is, that Rainier's adjusted basis for the trade names (which represented good will) was their March 1, 1913, value, $514,142 minus $138,137.40, rather than $514,142 minus $406,680.20 (R. 67–72). It is our position that the full $406,680.20 should be deducted from the March 1, 1913, value of $514,142 if the $1,000,000 Rainier received from Seattle is to be treated as capital gain rather than ordinary income.

There is no support in the Tax Court's findings (R. 60) for the Tax Court's intimation (R. 72) that Rainier had not "claimed" the full amount of obsolescence. No formal claim for abatement of taxes was made for 1918 and 1920, as it was for 1919, but the 1919 claim was for obsolescence in an amount greater than the Commissioner allowed for the three years 1918–1920, inclusive. Pursuant to this claim, Rainier's tax returns for 1918–1920, inclusive, were revised and its income for each of those years computed on the basis of an allowance for obsolescence.

As a result, Rainier received tax benefits for both 1918 and 1919. Under such circumstances, the amount of obsolescence allowed by the Commissioner must be deemed to have been claimed by Rainier and "allowed" by the Commissioner within the meaning of the statute. As the Supreme Court stated in *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523, 527–528, rehearing denied, 320 U. S. 810, where obsolescence was simply deducted by the taxpayer in his returns and the Commissioner had not even, as here, taken affirmative action at the instance of the taxpayer—

> "Allowed" connotes a grant. Under our federal tax system there is no machinery for formal allowances of deductions from gross income. Deductions stand if the Commissioner takes no steps to challenge them. Income tax returns entail numerous deductions. If the deductions are not challenged, they certainly are "allowed" since tax liability is then determined on the basis of the returns. Apart from contested cases, that is indeed the only way in which deductions are "allowed." And when all deductions are treated alike by the taxpayer and by the Commissioner, it is difficult to see why some items may be said to be "allowed" and others not "allowed." It would take clear and compelling indications for us to conclude that "allowed" as used in § 113 (b) (1) (B) means something different than it does in the general setting of the revenue acts. * * *

The fact that Rainier did not receive a tax benefit in the *full* amount allowed by the Commissioner as obsolescence has no bearing on the question whether the full amount was "allowed" within the meaning of the statute. In *Virginian Hotel Co.* v. *Helvering*, *supra*, the taxpayer had from 1927 through 1937 deducted depreciation on equipment on a straight line percentage basis. The Commissioner made no objection to these deductions but in 1938 determined that the useful life of the equipment was longer than claimed and that lower depreciation rates should be used. In determining the basis for 1938 and subsequent years under the same statute involved in the present case, the Commissioner subtracted the amounts of depreciation claimed in prior years, although those amounts were excessive as it later appeared. It was there stipulated that for the prior years 1931 through 1936 none of the claimed depreciation had reduced the taxpayer's taxable income and, accordingly, the taxpayer contended that the amount of depreciation claimed for the years 1931 through 1936 in excess of the amount properly "allowable" should not be subtracted from the depreciation basis, since it had not served to reduce its taxable income in those years. The Supreme Court rejected this contention, holding that the depreciation basis was properly reduced by the excessive amounts claimed in prior years, such amounts having been allowed."

That the full amount of obsolescence was "allowed" even though no obsolescence was "allowable" is illustrated by other decisions. In *Belknap* v. *United States,* 55 F. Supp. 90 (W. D. Ky.), which involved gain from the sale of a flock of sheep where the taxpayer had claimed depreciation in some years and not in others, it was stated (p. 97):

> Since the flock of sheep in question was not losing its usefulness but was being maintained through the methods adopted by the taxpayer the flock was not the type of personal property subject to an annual depreciation allowance within the provisions of the Regulations above referred to. Also since the sheep were acquired for purposes in addition to breeding, namely, for the sale of wool and for the resale of some of the sheep themselves from time to time, the taxpayer was not properly entitled to a reasonable allowance for depreciation allowed to farmers under the provisions of Article 23 (1) (10) of the Regulations above referred to. Since depreciation on the flock of sheep was not allowable to the taxpayer annually, and as a matter of fact it was not claimed for the years in question, the basis for determining the gain on the sale of the sheep in 1938 was their cost, less the depreciation which was erroneously taken and allowed for the years 1930 and 1931. * * *

In *Old Colony Trust Co.* v. *White,* 34 F. 2d 448 (D. Mass.), it was contended that depreciation was not to be taken into account in determining the gain from the sale of trust property, because the trustee could not legally deduct depreciation in his annual returns. The contention was rejected. Similarly, in *Hall* v. *United States,* 43 F. Supp. 130 (C. Cls.), certiorari denied, 316 U. S. 664, depreciation on leaseholds held in trust was denied by the Commissioner for years prior to the time depreciation as to leaseholds was allowed by statute and it was nevertheless held that, in computing gain from the sale of the leaseholds, the March 1, 1913, basis was to be reduced by the amount of depreciation from March 1, 1913, to the date of sale. Cf. *Helvering* v. *Owens,* 305 U. S. 468; *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301.

CONCLUSION

The Tax Court's holding that the $1,000,000 in promissory notes received by Rainier in 1940 from Seattle constituted the sale price of a capital asset, rather than ordinary income, is incorrect and should be reversed. If the Court concludes that the Tax Court's holding on that issue is correct, the Tax Court's decision is nevertheless erroneous on the obsolescence issue and should, for that reason, be reversed.

Respectfully submitted.

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APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain * * *.

(26 U. S. C. 1940 ed., Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss determined under section 111, shall be recognized, except as hereinafter provided in this section.

(26 U. S. C. 1940 ed., Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

(14) *Property Acquired Before March 1, 1913.*—In the case of property acquired before March 1, 1913, if the basis otherwise determined under this subsection, adjusted (for the period prior to March 1, 1913) as provided in subsection (b), is less than the fair market value of the property as of March 1, 1913, then the basis for determining gain shall be such fair market value. * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, * * * to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. * * *

(26 U. S. C. 1940 ed., Sec. 113.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l); * * *

* * * * *

(4) *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income; * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 117.)

Treasury Regulations 103, as promulgated under the Internal Revenue Code:

SEC. 19.22(a)–10. *Sale of Good Will.*—Gain or loss from a sale of good will results only when the business, or a part of it, to which the good will attaches is sold, in which case the gain or loss will be determined by comparing the sale price with the cost or other basis of the assets, including good will. (See sections 19.111–1, 19.113 (a) (14)–1, and 19.113 (b) (1)–1 to 19.113 (b) (3)–2, inclusive.) If specific payment was not made for good will there can be no deductible loss with respect thereto, but gain may be realized from the sale of good will built up through expenditures which have been currently deducted. * * *

SEC. 19.113 (b) (1)–1. *Adjusted basis: General rule.*—

* * * * *

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, * * *

* * * * *

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, * * * to the extent such deductions have in respect to any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under chapter 1 or prior income tax laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. * * *

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